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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

BOB STUMP, Chairman
GARY PIERCE
BRENDA BURNS
BOB BURNS
SUSAN BITTER SMITH

Arizona Corporation Commission
DOCKETED
AUG 19 2013
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IN THE MATTER OF THE COMMISSION'S INQUIRY INTO RETAIL ELECTRIC COMPETITION

Docket No. E-00000W-13-0135

NOTICE OF FILING ELECTRIC COMPETITION RESPONSIVE COMMENTS OF ARIZONA INVESTMENT COUNCIL

Notice is given that the Arizona Investment Council ("AIC") has filed its responsive comments regarding Staff's May 23, 2013 Notice of Inquiry in this Docket.

RESPECTFULLY SUBMITTED this 16th day of August, 2013.

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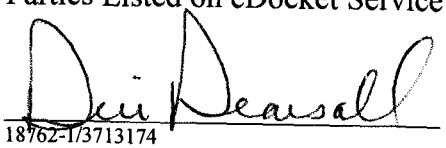

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Arizona Investment Council's Responsive Comments on Retail Electric Restructuring (Docket No. E-00000W-13-0135)

The Arizona Investment Council ("AIC"), on behalf of its 6,000 individual members – many of whom are debt and equity investors in Arizona utilities – as well as its utility and corporate members, submits these Responsive Comments.[1] Attached as Exhibit A are the AIC and Grand Canyon's Rebuttal Comments on certain legal issues.

INTRODUCTION

In reviewing selected comments filed by those supporting electricity restructuring, many supporters either ignore or gloss over critical economic and legal issues that are integral to the Commission's decision as to whether to move this matter forward. The old "competitive" rules – first adopted by the Commission in 1996 and modified seven times before being overturned by the Court – cannot be resurrected by removing the cobwebs and blowing off the dust as suggested by supporters. The legal infirmities that thwarted the original rules cannot be wished away and the billions of dollars in costs for, *inter alia*, recovering stranded investments, revamping utility systems and the creation and continuing funding for an Independent System Operator ("ISO") or Regional Transmission Organization ("RTO") are real and cannot be ignored. Should the Commission move forward with restructuring, it must require that investors be fairly compensated for investments made under and in reliance on the regulatory compact. It will be a complex, contentious and expensive undertaking for the Commission, the utilities, customers and all stakeholders.

Arizona is not New York, New Jersey or Pennsylvania, where high costs of electricity prompted lawmakers there to impose new market models in desperate attempts to force prices lower – only to see them skyrocket when price caps were lifted. In Arizona, the traditional regulatory model has done its job in keeping rates at stable and affordable levels without subjecting customers to the added costs and uncertainties inherent in restructured market models. The track record of restructuring in California, Texas and in the Northeast is not a good one – it has not produced benefits for all customers nor met the promises of promoters.

[1] More than 50 commenters filed statements – pro and con – relating to various aspects of retail electric competition on July 15, 2013. AIC responds on certain selected issues and its failure to address any particular position or assertion is not to be construed as agreement with or acquiescence to it.

The July 15 filings of restructuring supporters are bereft of substantial, much less conclusive, evidence that restructuring is in the public interest. The Commission should not abandon the current system by acceding to the economic self-interests of energy marketers, large industrial customers and merchant power plant operators.

The supporters of restructuring have failed to provide justification to exchange the current form of electricity regulation in Arizona – which has produced stable rates at levels below the national average – for one with greater costs and uncertainty for Arizonans. Proponents' continued reliance on the Texas model as an exemplary model of restructuring is bewildering at best, given that state's record of supply inadequacies and rolling blackouts, coupled with the huge volume of consumer complaints about hidden fees and questionable marketing schemes and practices under the Texas "competitive" regime. It is clear those groups promoting restructuring in Arizona, driven by their own self-interests, stand ready to import these problems to our State as well.

Simply stated, the burden of proof for restructuring to move forward in Arizona has not been met.

What follows are AIC's selective, responsive comments.

GOLDWATER INSTITUTE

1. At pages 4-5, the Goldwater Institute ("GI") claims that electricity deregulation produces lower prices by an invalid rates comparison when it compares a provider's price in Texas to average prices in Arizona. We don't know (and GI doesn't tell us) whether the provider's price is an average price experienced by customers on a particular rate schedule, is seasonal or is a component of a rate schedule with other conditions imposed on the bill, such as different rates applied at different time periods or days, or levels of fixed costs that might apply. The bottom line is that today, customers of APS, TEP and SRP can avail themselves of rate schedules that have prices lower than average prices in Arizona, so GI's "revelation" does not qualify as breaking news. As an example: A customer on SRP's time-of-use rate pays 6.92 cents per kWh for power off-peak during most summer months – well below the State's average price of 11.1 cents per kWh.

   Similar alternative rate schedules are available for TEP and APS. Directly countering the GI claim is that an apples-to-apples comparison based on the latest data provided by EIA (for 2011) shows the average residential rate for electricity in Texas is about equal to that in Arizona at 11.1 cents per kWh. Further, it's only in the past year that the average rate in Texas has not been higher than Arizona's average rate, despite Texas' 11-year experience with deregulation. In 2006, when

natural gas prices spiked, the average residential price in deregulated Texas was 37 percent higher than the average residential price in Arizona (12.86 cents/kWh v. 9.4 cents per kWh).

2. At page 6, GI makes the assumption that "competitive markets will result in an abundance of relatively cheap energy that will benefit all customer classes equally." The evidence shows otherwise. One indication of how customer classes benefit is the rate at which customers take advantage of alternative providers. In every state (except Texas, where all residential customers were forced to switch) that has restructured its electricity market for competitive entry, large customers are quick to switch providers, while residential customers are less inclined to take advantage of any perceived benefits by switching. In New Jersey, for example, the most recent ABACCUS[2] report indicates that 87.6 percent of large industrial customers switched to an alternative provider, while only 14.3 percent of residential customers shifted. Even after Pennsylvania completed its transition to retail access, the rate of switching among large industrial customers is three times that of residential customers. Clearly, large customers, which produce the greatest profit margin for alternative providers under electric competition, benefit the greatest. Smaller business customers and residential customers benefit the least, if they benefit at all.

3. At page 6 continuing, GI's claim that "competitive markets will result in an abundance of relatively cheap energy" is not supported by market experience. In Texas, providers have been reluctant to bring new base load generating capacity on line due to the uncertainty of cost recovery for long-lived assets in a competitive market. The result is diminishing reserve capacity in Texas, which jeopardizes reliability and places upward pressure on prices.

4. Page 7: GI simply assumes away any potential market manipulation by asserting horizontal and vertical divestiture together with "market monitoring" will cure any problems of market power. Here, GI suffers from amnesia – these purported market cures failed miserably in California and the Federal Energy Regulatory Commission ("FERC") continues to issue fines for market manipulation to energy traders. The theoretical concept that altering market structure through divestiture coupled with monitoring will solve these complex matters is simply "whistling past the graveyard." After two decades of deregulation experience, structural flaws in wholesale markets' operations continue to exist. Market oversight by RTOs has been unable to cure market abuses. The result? Increased costs to consumers in many deregulated states and regions. In many cases, the FERC has stepped-in and issued fines to energy traders accused of market manipulation.

[2] 2012 ABACCUS: "An Assessment of Restructured Electricity Markets," Distributed Energy Financial Group LLC, December 2012.

In a December 2012 article by Elise Caplan and Stephen Brobeck[3], the authors found that restructured electricity markets have not benefited consumers. According to the study, *"The evidence is clear that generators are profiting excessively from RTO power markets, and that sellers' rates are not 'just and reasonable' as the law requires. Consumers are paying the price, to their detriment and that of the overall economy."* The contention by GI and other supporters of restructuring that the mere creation of an RTO or that the Arizona Independent Scheduling Administrator Association ("AZISA") can somehow eliminate market manipulation is not borne out and, instead, is thoroughly refuted in practice.

5. Page 8: GI's answer to Question 7 is inconsistent with its answer to Question 5. In its answer to Question 5, GI states that issues with market manipulation can be solved by horizontal and vertical divestiture of incumbent providers' assets, while GI's answer to Question 7 indicates deregulation can also be accomplished without divestiture. Perhaps GI recognizes that forced divestiture of assets is not possible in Arizona and simply wants to cover all bases.

6. Pages 8-9: Contrary to GI's assertion that "[t]here would be few other costs because stranded costs have already been recovered by incumbent utilities" is in error. As one obvious example, investments in renewable energy projects approved by the ACC since 2006 have not been fully recovered by utilities and would likely be stranded in a deregulated electricity market. Previous estimates of stranded investments resulting from restructuring for Arizona utility companies exceed $1 billion, which must be recovered from customers.

   Additionally, other costs for implementing deregulation are ignored by GI, including, but certainly not limited to, retooling utility hard- and software, costs for educating consumers on their options and rights under deregulation and additional costs incurred by the ACC in establishing regulations, resolving disputes between customers and providers and policing the market. Presumably, the ACC will have responsibility, *inter alia*, for ensuring all competitive retail providers keep promises made to customers and determining whether providers utilize deceptive or false advertising to lure customers into taking service. These kinds of problems are common in those states that have restructured. Oversight of these and other "competitive market" issues will require new regulatory skills and resources. In its Exhibit 1, GI once again relies on a theoretical concept to address customer issues. GI essentially says consumers can switch to another provider if the chosen provider fails to deliver on pricing, service quality or green power

[3] Caplan, Elise and Brobeck, Stephen, "Have Restructured Wholesale Electricity Markets Benefited Consumers?" Electricity Policy.com, December 2012, https://www.publicpower.org/files/PDFs/CFA_APPA_RTO_Article_12_12_12.pdf.

promises. According to GI, the ACC should not intervene in such consumer issues and ". . . should resist the urge to impose regulation on the retail and generation electric markets beyond bonding requirements, which are more consistent with flexible markets than more intrusive and arbitrary licensing regulations." In GI's competitive world, residential, small commercial and other more sophisticated consumers will have near perfect information and are at risk for analyzing and choosing wisely. But, it would be unrealistic (and quite unconscionable) for the ACC to abandon any regulatory oversight when consumers are saddled with introductory rate offers, hard-sell sales pitches or multi-year contracts for a service so essential to everyday life in Arizona's harsh summer climate and for which there are few substitutes or replacements.

A recent article in the *Dallas Morning News* ("Electricity companies add on scores of fees," August 11, 2013)[4] outlines the kinds of issues consumers face in a restructured electricity market. One example is a $5 dollar fee charged by several competitive providers if bill payment is made with the help of a live agent. Another company increases the kWh charge by about 50 percent – from 10.3 cents/kWh to 15 cents/kWh if the customer does not make automatic payments from a bank account. Some suppliers add on exorbitant disconnect and reconnection fees, fees for copies of billing records or penalties if electricity consumption falls below a specified consumption level. Despite GI's admonition to avoid regulation of suppliers, these consumer problems will fall on the ACC to resolve. Unfortunately, Adam Smith is unavailable to take complaint calls from consumers about these "benefits" of competition.

7. Pages 9-10: GI again relies on a theoretical construct to assume that "market forces will generate reliable electrical production equivalent or superior to regulated monopoly systems." Experience says otherwise. In Texas, "market forces" have led to under-investment in generating capacity, resulting in insufficient reserve margins and rolling blackouts. Generating assets have high capital costs, are long-lived and carry long payback periods. Investors are reluctant to invest capital in projects where the risks are high and the uncertainty of returns is great, which is what exists in competitive electricity markets. GI clearly recognizes the prospect of supply shortages in a competitive market when it states, ". . . regulators will have the power to establish demand mitigation policies to minimize non-essential consumption during supply shocks." One question the ACC must ask itself is whether it is prepared to issue rationing orders when the competitive market fails to supply sufficient capacity under the hope market forces will bring additional capacity on line.

[4] Leiber, Dave, "Electricity companies add on scores of fees," *Dallas Morning News,* Aug. 11, 2013, http://idmn.dallasnews.com/local-and-state/20130811-electricity-companies-add-on-scores-of-fees.ece.

WAL-MART

In its answer to Question 17, Wal-Mart states that ". . . resource planning is not appropriate for a fully competitive retail market." Unfortunately, Wal-Mart is correct in that response, because a competitive power market is focused on short-term supply and demand. Therefore, long-term planning of capital intensive generation resources is problematic. In Texas, producers are reluctant to make investments in large generation projects – both given the uncertainty associated with recovering their costs, as well as the impact more supply would have to lower prices generators are currently receiving. The result has led to diminishing reserve margins and rolling blackouts in Texas. Very simply, resource diversity and system reliability are major concerns in any shift to a deregulated or restructured electricity market. The utilities in Arizona's current regulated market consider both short-term and long-term resource needs through resource planning processes, because they have a responsibility to meet the State's electricity demand. Consequently, Arizona residences and businesses today enjoy a highly reliable power system scaled to meet peak demand throughout the year from a diverse portfolio of generation assets and fuel sources. Replacing this sophisticated planning process, and the safe and reliable power grid that has resulted from it, with the invisible hand of market forces is a risk Arizona regulators need not take – especially when the potential benefits of restructuring accrue solely to a select group of large customers, like Wal-Mart.

NATIONAL ENERGY MARKETERS ASSOCIATION ("NEMA")

1. NEMA, in its response to Question 1 regarding prices, uses an "apples to oranges" comparison of rates for Texas. NEMA cites to a 2013 Texas PUC report that claims "[R]etail customers have benefited from available rates well below, on an inflation adjusted basis, the last regulated rates charged by electric utilities prior to the implementation of retail choice in 2002." While this statement might be true for selected customers on selected rate schedules, a comparison of average prices for the state paints a different picture. Based on data from the EIA between 2002 and 2011, the *average residential price* increase in Texas was about equal to the increase in inflation – measured by the CPI at roughly 25 percent over that period. However, between 2002 and 2008, the average electricity price in Texas increased by a whopping 45 percent, significantly outpacing inflation during the same time period. Since the 2008 price spike, the average residential price in Texas has drifted down. Like gasoline prices, electricity prices in deregulated Texas shot "up like a rocket" and have "fallen-back like a feather."

2. In its answers to Questions 4 and 5, NEMA states the Commission can prevent market abuses and market manipulation by adopting strong code of conduct regulations and provides a list of activities the Commission should engage in. NEMA does not say how these oversight activities could be implemented, nor does it provide an estimate of Commission resources and tax or ratepayer costs for policing this new area of regulation and responsibility. If NEMA had also referenced the 2013 Texas PUC report in its answers to Questions 4 and 5, it would have reported that the Texas PUC assessed $3.8 million in penalties for market and service quality violations by providers, while revoking operating certificates of eight providers, suspending the certificate of another and accepting the relinquishments of 15 providers' certificates.

3. NEMA, in its response to Question 9 regarding system reliability, states that restructuring will not negatively impact it. However, the 2013 Texas PUC report that NEMA previously referenced recognizes that the competitive market in Texas has failed to bring new generating resources on line to meet future projected demand. As a result, reserve margins are projected to fall below acceptable levels. The Texas PUC must now evaluate how to intercede in the wholesale market to provide incentives for new investment in capital intensive, long-term generating assets. Left to its own device, Texas' invisible hand of competition will, in all likelihood, lead to a further erosion of system reliability and increased prices.

RETAIL COMPETITION ADVOCATES ("RCA") AND RETAIL ENERGY SUPPLY ASSOCIATION ("RESA")

1. In its response to Question 1, RCA and RESA tell the Commission that "The benefits of robust, sustainable retail competition extend beyond a simple analysis of price." Why? Very simply, because the average residential price in Arizona is presently below the price in those states that have deregulated and below the national average as well. For residential customers, the current regulated model overseen by the ACC works quite well in keeping prices stable. Furthermore, should Arizona move forward with restructuring, it is likely that average prices for the State's residential customers would increase due to cost shifting, as well as costs related to stranded investment recovery, IT and administrative changes by the utilities, establishment and operation of an RTO and customer education programs. Therefore, to shift attention away from prices and cost shifting, which will occur under restructuring, RCA and RESA focus on customer choice as a main benefit of restructuring. However, the evidence of consumer benefits from choice is lacking as well. With the exception of Texas, where all customers were required to select a provider or have one assigned, residential customers have not enthusiastically embraced the idea of selecting an alternative provider. In New Jersey, a deregulated state, only 14 percent of residential customers have chosen

an alternative provider. Even in the State of Pennsylvania, which has been cited as a model for Arizona and where restructuring has been in transition since 1997, less than one-third of residential customers have selected an alternative provider.

2. In its response to Question 4 regarding risks to residential ratepayers, RCA/RESA, rather than answering the question, turns to a defense of criticisms posed by opponents of restructuring, principally the issues of supplier reliability and cherry picking. However, another risk relates to challenges with market structure and default service, such as the risks presently facing residential customers in New Hampshire, as articulated in one of the references RCA/RESA cites[5]. It is yet another reason why restructuring can produce unanticipated results. In New Hampshire, where the average price of residential service (16.5 cents per kWh) is substantially greater than the national average (11.7 cents per kWh), residential customers taking default service from the large incumbent provider, Public Service Company of New Hampshire (PSNH), face prices greater than the competitive price for electricity. Yet, this higher price has failed to induce substantial migration of residential customers to alternative providers, thus thwarting any potential cost benefits of restructuring for these customers. It is also a strong indication that residential consumers place a low value on choice and place greater trust in the traditional utility provider.

3. RCA/RESA's response to Question 5 regarding how the Commission can guarantee there would be no market structure abuses is not convincing and provides the Commission with little comfort that such abuses will be prevented. First, RCA/RESA misses the point of the Commission's probe in this area when it states the first line of defense is the Commission's oversight of CC&Ns of competitive retail providers. This has nothing to do with the question of market structure and market manipulation. It occurs on the wholesale side, which is not regulated by the ACC.

   Next, RCA/RESA gives the Commission assurance that the AZISA, through its protocols to govern market operations, will prevent such abuses, even though the AZISA, with a current staff of a single person, has no operational capacity and has yet to perform any real market oversight activities since its creation in 1998. Moreover, evidence shows that ISOs and RTOs with years of real market experience have been unable to curb such abuses in areas in which they operate. Accordingly, the FERC has issued hundreds of millions of dollars in fines and consumer restitution orders to energy traders who have engaged in market manipulation practices. The most recent FERC action involving market

[5] Staff of the New Hampshire Public Utilities Commission and Liberty Consulting, "Public Service Company of New Hampshire: Report on Investigation into Market Conditions, Default Service Rate, Generation Ownership and Impacts on Competitive Electricity Market," June 7, 2013, http://www.puc.nh.gov/Electric/IR%2013-020%20PSNH%20Report%20-%20Final.pdf.

manipulation by energy trader JP Morgan Ventures Energy Corporation just last month led to a settlement of $410 million in penalties and restitution to be paid by JP Morgan.

4. RCA/RESA responds to Question 8 by listing, but not quantifying, three categories of transition costs for restructuring – AZISA-related costs; utility system implementation costs; and customer education. RCA/RESA conveniently ignores costs of stranded assets of incumbent utilities, which must also be recovered from customers. During the last effort at restructuring, the value of Arizona utility stranded investment was estimated at over $1 billion. Assuming that AZISA, as currently authorized, is even capable of engaging in grid oversight, the start-up costs for ramping up to a professional organization with sufficient technical and human capacity could cost over $100 million, together with ongoing operating costs of tens of millions of dollars based on the experience of other ISOs and RTOs. IT costs: The last time Arizona utilities prepared for restructuring in the 1990s, the combined system costs were $100 million for Arizona utility companies. The administrative systems developed then are now obsolete and must be replaced at even higher costs. Customer education is critical for successful market restructuring and the ACC should be prepared to lead that effort. It will be expensive and these costs will also be ultimately borne by customers.

5. RCA/RESA claims that ". . . competitive suppliers will and should be expected to meet established resource adequacy reliability requirements, including maintenance of an acceptable planning reserve margin of capacity and appropriate levels of operating reserves." Unfortunately, "should be expected to meet" is an insufficient and inadequate response for resource investment and deployment in a climate as harsh as Arizona's. The restructured experience in Texas indicates that the "invisible hand of competition" has failed to bring additional, long-term generating capacity to market and has resulted in deteriorating reserve margins and rolling blackouts. The Texas PUC has, therefore, interceded in the "competitive" wholesale market.

ARIZONANS FOR ELECTRIC CHOICE & COMPETITION ("AECC")

1. In its answer to Question 1, AECC explains that under restructuring, whether classes of customers experience reduced rates depends on the extent to which rates are presently subsidized. AECC has long held the proposition, in the numerous rate cases in which it has intervened in Arizona, that its members pay rates in excess of their cost of service. Another way of expressing AECC's answer to Question 1 is that restructuring will result in a shift of costs away from its large industrial customer members onto other customer classes – namely the residential

class. Although AECC does not explicitly state that rates for residential customers will likely increase should the Commission decide to restructure Arizona's electricity market, it is, nevertheless, the likely outcome.

2. In its answer to Question 3, AECC assumes equitable benefits among customer classes can be accomplished by simply permitting all customer classes to participate in direct access. However, experience in restructured states indicates benefits among customer classes are uneven. One indication of the uneven level of benefits is the rate of customer switching to alternative providers. In states like Pennsylvania, for example, large industrial customers have switched to alternative providers at three times the rate of residential customers. With the exception of Texas (where switching was forced), this disparity exists in other restructured states. Simply permitting all classes to participate in direct access does not mean benefits will be equal for all classes. AECC provides another clue to the likely disparity of benefits in its answer to Question 1, in which it equates potential lower rates from restructuring to the degree of cross-subsidization that currently exists across customer classes. Clearly, the short-term benefits to AECC members from restructuring will greatly outweigh any potential benefits to other classes of customers, particularly small businesses and residential customers.

ARIZONA COMPETITIVE POWER ALLIANCE ("ACPA")

1. ACPA argues that Arizona customers benefited from the ACC's last efforts to restructure the electricity industry ". . . before the ACC reversed course." ACPA claims Arizona customers saved "hundreds of millions of dollars in the form of lower retail rates and decreased wholesale costs." However, ACPA fails to mention the higher rates imposed by the ACC on customers to recover hundreds of millions of dollars of transition costs related to the prior ill-fated restructuring effort.

2. In discussing APS' decision to postpone a decision on its acquisition of the Four Corners Power Plant, ACPA suggests that the threat of competition has led APS to reconsider the transaction on the basis that ". . . captive ratepayers are no longer on the hook for any environmental cost overruns" under a competitive framework. Clearly, ACPA's members who own and operate natural gas plants in Arizona would like nothing more than for Arizona's coal generation fleet to be idled and believe retail access coupled with environmental mandates will hasten that outcome. However, should retail access render Arizona's coal fleet uneconomic, as ACPA seems to cleverly suggest, customers will, nevertheless, be on the hook for recovery of any stranded investments.

CONCLUSION

Retail Electric Restructuring is simply not in the general public's best interests. It faces, among others, legal, regulatory, economic and reliability issues that simply can't be ignored or wished away by proponents. The Commission should forego yet another costly attempt at restructuring Arizona's electric industry.

EXHIBIT A

EXHIBIT A

REBUTTAL COMMENTS IN RELATION TO QUESTION 13 OF THE COMMISSION'S MAY 23, 2013 NOTICE OF INQUIRY INTO RETAIL ELECTRIC COMPETITION IN ARIZONA
Regarding *Phelps Dodge* and Other Legal Impediments

I. INTRODUCTION.

These rebuttal comments respond to certain legal arguments raised by those in favor of implementing retail electric competition in Arizona (the "EC Supporters"). In light of the large number of comments filed in Docket No. 13-0135 (more than 50 filings were submitted), it is impracticable to attempt to respond to all of the EC Supporters' assertions. This is especially true given the fact that we are responding to a purely theoretical construct with no specific proposed rules to assess. Our failure to respond to any issue raised by EC supporters is not to be construed as agreement with or acquiescence to it.

With these considerations in mind, these rebuttal comments focus primarily on recurring themes in several of the EC Supporters' filings, including: arguments relating to the 1998 retail electric competition statutes; whether and to what extent the 1999 Commission Rules are still viable or revivable; and misinterpretations of the holdings of and the regulatory requirements set forth in *Phelps Dodge Corp. v. Arizona Elect. Power Coop.*, 207 Ariz. 95, 83 P.3d 573 (App. 2004).

II. DISCUSSION.

A. The Commission's 1999 Retail Electric Competition Rules Are Not Valid or Revivable.

As Utilities Division Director Steve Olea correctly recognizes: following *Phelps Dodge*, the Commission's 1999 Retail Electric Competition Rules (the "Rules") are "Swiss cheese," at best. Several EC Supporters ignore this fact – incorrectly suggesting that the Rules are still largely enforceable. In fact, *Phelps Dodge* held many of the Rules procedurally and substantively invalid in whole or in part. As it stands, there is simply no practical way to use or enforce the Rules that remain.

Further, *Phelps Dodge* expressly left open the possibility that any of the Rules which remain hobbled, but standing somewhat, could be deemed unconstitutional *as applied*. The Cooperatives in *Phelps Dodge* challenged the *facial* validity of certain Rules, not the validity of those Rules *as applied*. 207 Ariz. at 106-110, ¶¶ 29, 45-52, 83 P.3d at 584-88. The Court distinguished between the two, stating: "[t]he Rules are unconstitutional on their face if they cannot be applied under any circumstances without violating Article 15, Sections 3 and 14 . . . Otherwise, their constitutionality can only be attacked as applied in particular circumstances." *Id.* at 109-110, ¶ 46, 83 P.3d at 587-88.

This distinction is significant because several of the Rules that the Court did not invalidate in *Phelps Dodge* are nevertheless quite susceptible to challenge as applied. For example, the Cooperatives challenged certain Rules that would "allow ESPs to charge different rates to similarly situated customers," in violation of the antidiscrimination provisions in Article 15, Section 12 and A.R.S. § 40-334. The Court simply held that this issue was not yet ripe for review. *Phelps Dodge*, 207 Ariz. at 119, ¶ 99, 83 P.3d at 597. The Court reasoned: "[u]ntil an ESP charges a rate that allegedly violates these provisions, allowing the court to apply legal principles to a concrete set of facts, the issue is not ready for review." *Id.* This holding does not change the fact that those Rules are written in a way that makes it possible for ESPs to charge discriminatory rates. Thus, it is only a matter of time before the Rules will be challenged as applied.

As APS notes at pages 27-28 of its July 15 comments, a closely related legal impediment is the price transparency requirements of A.R.S. § 40-367 which requires prices be held open for public inspection. Thus, the price secrecy of individual transactions which competitive providers no doubt will seek under broad ranging, flex tariffs is statutorily prohibited.

Other EC Supporters try to downplay the impact of *Phelps Dodge* by arguing that several of the Rules declared invalid can be immediately revived by simply submitting them to the Attorney General for review and approval. This argument is misguided and naive. While it is true that several of the Rules were held invalid because they were not sent to the Attorney General, much more than a decade has passed since those Rules were passed, and nearly a decade has passed since *Phelps Dodge* declared them invalid. Yet, they *still* have not been submitted for Attorney General review. As legal and practical matters, it is simply too late to hit the rewind button. Further, even trying would create a host of related problems.

As APS correctly recognizes in its comments: "[s]ome of these rules have become moot or at least dated by the passage of so much time." APS Comments at p. 26. And "[t]he Economic, Small Business and Consumer Impact Statements that accompanied the original Electric Competition Rules, and which are required by the APA, are likewise stale." *Id.* "Bottom line, the rules for any contemplated deregulation are effectively nonexistent, and need to be formulated, debated, and, if passed, submitted to the AG in accordance with the law." *Id.*

B. Retail Electric Competition Is Inherently Antithetical to the Requirements of *Phelps Dodge.*

EC Supporters argue that the competitive market can operate within the parameters of *Phelps Dodge*. However, in making this argument, their comments consistently contradict or altogether ignore two key *Phelps Dodge* holdings:

(1) The Commission is required to *use* fair value in a meaningful way in setting just and reasonable rates; it is not enough to find fair value and then disregard it. *Phelps Dodge*, 207 Ariz. at 128, ¶ 152, 83 P.3d at 606 ("Even in a competitive market, Article 15, Section 14, of the Arizona Constitution requires the Commission to determine the fair value of Arizona property owned by a public service corporation *and consider that determination in establishing just and reasonable rates.*") (emphasis added); *see also US*

West Communications, Inc. v. Arizona Corp. Com'n, 201 Ariz. 242, 246, ¶ 20, 34 P.3d 351, 355 (2001) ("We do not hold that a fair value determination should play *no* role in the establishment of rates, or that it can simply be ignored. On the contrary, section 14 mandates that the corporation commission determine fair value "to aid it in the proper discharge of its duties.") (emphasis added). To the extent that EC Supporters suggest that the Commission can find fair value and then simply disregard it, they are clearly mistaken. *See id.*

(2) Further, while it is permissible for the Commission to set a range of rates, the range must be sufficiently narrow so as not to undermine or ignore the Commission's obligation to set just and reasonable rates. *Phelps Dodge*, 207 Ariz. at 107, ¶ 33, 83 P.3d at 585 ("We reject the Commission's contention that its approval of a broad range of rates within which the competitive marketplace can operate satisfies the Commission's obligation to set just and reasonable rates.") (emphasis added). In so holding, *Phelps Dodge* rejected a range of rates that would have given PG&E the ability to negotiate within its proposed range of roughly 500 to 800 times the wholesale cost of electricity. Across the board, the EC Supporters' comments recognize that *Phelps Dodge* permits ranges of rates, but completely ignore the requirement that those ranges to be sufficiently narrow to conform to the case's requirements. Undoubtedly, this is because most, if not all, of the pending retail electric competitors' CC&N applications propose ranges of rates either without ascertainable caps or ranges that are capped at amounts dozens of times greater than wholesale electricity prices (in other words, they are effectively unrestricted prices). The EC Supporters' efforts to ignore the *Phelps Dodge* holding will not make it go away – unlimited ranges of rates within which the competitive market can operate are not permissible. *Id.* Once again, this begs the question: "Is there a permissible range of rates that would even appeal to a competitive electric service provider?" Based on the CC&N applications, we submit that there is not.

C. The 1998 Retail Electric Competition Statutes Are Also Susceptible to Challenge.

At least one EC Supporter argues that the Arizona Legislature has fully authorized retail electric competition through statutes enacted in 1998 (via HB 2663) (the "Statutes"). While it is true that these Statutes have not been declared invalid, they are very susceptible to challenge under *Phelps Dodge*.

When the Arizona Legislature enacted the Statutes, it published an express declaration of legislative intent that recognized several "specific policies" that the Legislature sought to outline in the Statutes. Laws 1998, Ch. 209, § 35, Legislative Intent. The first policy states: "retail electricity prices set by a competitive market meet the *constitutional* test of being just and reasonable." In *Phelps Dodge*, the Arizona Court of Appeals was asked to determine whether R14-2-1611(A) – declaring that "market determined rates . . . shall be deemed just and reasonable" – was invalid. The Court held this Rule *facially unconstitutional* because it improperly delegated the Commission's constitutionally mandated ratemaking responsibilities to the marketplace. *Phelps Dodge*, 207 Ariz. at 108, ¶ 39, 83 P.3d at 586. It follows that because the primary policy upon which the Legislature relied in drafting and enacting the Statutes was

subsequently declared unconstitutional in *Phelps Dodge*, the Statutes themselves remain quite susceptible to challenge.

Finally, at least one EC Supporter argues that *Miller v. Arizona Corp. Com'n*, 227 Ariz. 21, 251 P.3d 400 (Ct. App. 2011), "essentially overruled" *Phelps Dodge*. This argument is a red herring. In *Miller*, the plaintiffs challenged the Commission's renewable energy rules. The Court held that there was "a sufficient nexus between the REST rules and ratemaking," and that "[p]rophylactic measures designed to prevent adverse effects on ratepayers due to a failure to diversify electrical energy sources fall within the Commission's power 'to lock the barn door before the horse escapes.'" 227 Ariz. at 29, ¶ 31, 251 P.3d at 408.

This case obviously did not overrule any *Phelps Dodge* holding. Rather, it was a challenge to a separate, distinct and what the Court ruled was a proper exercise of the Commission's ratemaking power. *Phelps Dodge*, on the other hand, held that the Commission's attempt effectively to ignore several of its constitutional and statutory obligations did not pass muster.

III. CONCLUSION.

The EC Supporters' comments do not overcome the many legal impediments to retail electric competition in Arizona under *Phelps Dodge* and other settled law. Simply stated, a market where the "invisible hand of competition" sets electric rates is constitutionally barred in the Grand Canyon State.